

SECTION II – SPECIFIC COMPLIANCE
FUND 30 – CAPITAL PROJECTS FUND

Bond and Note Authorizations

Bonds and notes authorized by the voters (Type II) or the Board of School Estimate (Type I) are "Other Financing Sources" in the capital projects fund in the year of issuance/sale. Funds received from the sale of bond anticipation notes are not to be considered "Other Financing Sources." Refer to Chapter 13 of the GAAP Technical Systems Manual.

GASB 34 Model

Districts that are implementing GASB 34 will continue to report bond proceeds as "Other Financing Sources" in the governmental funds statements, but will present this as a liability on the *Statement of Net Assets*.

The Board has no power to make contracts prior to voter approval (Type II) or adoption of an ordinance by the governing body (Type I). Overexpenditures in the capital projects fund are not a reportable condition unless the total project expenditures exceed the total bond authorization of the entire construction project.

Bond Sales and Capital Projects Fund Activities

All proceeds related to the sale of bonds are recorded in the capital projects fund. The board cannot use a premium in excess of the bond authorization or the accrued interest for capital purposes since the board is limited by the amount voted or certified. Receipts from premiums in excess of the authorization are transferred to the general fund or debt service fund. Receipts from accrued interest are transferred to the debt service fund.

Because of statutory limitations, interest earned on the investment of unexpended cash balances in the capital projects fund must be transferred by board of education resolution to either the debt service fund or the general fund at the discretion of the board of education. Interest earned cannot be used for the referendum project(s) unless expressly authorized, with the amount, in the referendum. Any amounts not transferred at June 30th must be recorded as an interfund receivable/payable. Other important issues related to the general fiscal administration of the capital projects fund are discussed in Policy Bulletin 200-13 dated October 1992. Guidance is also found in *N.J.A.C. 6A:26-4* and the October 2001 guidance issued by NJDOE on *EDA Accounting* and on *Capital Reserve Accounting and Recording*. The proper accounting procedures related to capital projects are included in Chapter 11 of the GAAP Technical Systems Manual.

Capital Project Approval Under Educational Facilities Construction Financing Act (EFCFA)

Under EFCFA, effective July 18, 2000, districts may not advance a school facilities project for which it is seeking state support or an other capital project (as defined in *N.J.A.C. 6A:26-1.1*), until the school district has an approved LRFP and has received specific project approval of the school facilities or other capital project. Only school facilities projects approved under the waiver process or approved as an emergent school facilities project under *N.J.A.C. 6A:26-3.16* may proceed without an approved LRFP. Districts which have begun a school facilities project or other capital project after the passage of EFCFA, should have available for auditors a copy of the DOE final determination letter (approval of the LRFP) and a copy of the school facilities or other capital project approval letter.

Non-Abbott districts must obtain voter approval or board of school estimate approval for the local amount of the capital project (pursuant to *N.J.A.C. 6A:26-3.7* and *3.12*) or use capital reserve pursuant to *N.J.A.C. 6A:26-9.1*. State support for the project is available once the district secures financing for the local amount of the project.

Pursuant to *N.J.A.C. 6A:26-3.7(e)* and *(g)*, the bond referendum (or board resolution for Type I or Type II districts having a board of school estimate) must identify the final eligible costs of the project, as determined by the Commissioner of Education, the total costs, state share or state debt service percentage, the local share and the amounts that are in addition to the facilities efficiency standards. If the district is using a combination of school bonds and other financing sources, the referendum question must also include the portion of the local support to be raised through other revenue sources, listing separately each source and the amount from that source.

Unexpended Bond Proceeds

A capital project is considered completed for the purposes of determining unexpended bond proceeds when the project has received its certificate of completion from the contractor; all retainage has been liquidated; and a permanent certificate of occupancy has been received, if applicable (*N.J.A.C. 6A:26-4.6(a)*).

Any proceeds of school bonds issued by the district for a school facilities project prior to the effective date of EFCFA, and that received no funding under EFCFA except for retroactive funding received pursuant to *N.J.A.C. 6A:26-13.1(b)*, or issued by the district for an other capital project (as defined under *N.J.A.C. 6A:26-1.2*), which remain unspent upon completion of the capital project, shall be disposed of by the district in accordance with *N.J.S.A. 18A:24-47* et seq.

1. Unexpended balances may remain in the capital projects fund for six years after the time of issuance or sale of bonds.
2. Within six years of issuance or sale, if a new purpose(s) for the unexpended balances is determined, the board of school estimate, capital projects review board, or voters may approve the change in purpose by resolution or ballot question. The resolution or ballot question for the new purpose shall receive Commissioner approval if the bonds mature beyond the period prescribed for the new purpose(s) by *N.J.S.A. 18A:24-5*.
3. If no new purpose for the unexpended balances is determined within the six years from issuance or sale, the board of education may transfer the funds to either the general fund or debt service fund by board resolution. To meet the criteria for no new purpose, the district's budgeted appropriations and actual expenditures for the year of the transfer may not reflect capital outlay spending.
4. After six years of issuance or sale, unexpended balances must be transferred to either the general fund or the debt service fund by board resolution.
5. Pursuant to *N.J.A.C. 6A:26-4.6(c)*, any proceeds of school bonds issued by the district for the purpose of funding a non-EDA constructed school facilities project after the enactment of EFCFA which remain unspent upon completion of the school facilities project shall be used by the district to reduce the outstanding principal amount at the earliest call date or annually reduce the debt service principal payments. If the unexpended proceeds are used to annually make debt service principal payments, the proceeds must remain in the capital projects fund and be appropriated in each subsequent year's budget certified for taxes to reduce the debt service principal payment in full each year until the proceeds are exhausted.

Upon completion by the EDA of a school facilities project, any local share required to be returned to the district pursuant to *N.J.S.A. 18A:7G-5(p)* and *N.J.A.C. 6A:26-3.7(h)*, shall be used by the district to reduce the outstanding principal amount of any school bonds issued by the district for said local share. The principal amount shall be reduced at the earliest call date or annually through the reduction of the debt service principal payments in accordance with *N.J.A.C. 6A:26-4.6(c)*. If school bonds were not

issued for said local share or the principal amount has been fully repaid, the local share returned shall be recorded as revenue in the district's general fund.

Economic Development Authority (EDA) Grants under EFCFA

All grants received from the EDA pursuant to *N.J.S.A.* 18A:7G-15 for the state share of approved school facilities projects, except for grants received for retroactive funding under *N.J.A.C.* 6A:26-13.1(c) for completed projects that did not issue short term notes, are recorded by project in the capital projects fund along with the corresponding local share. Pursuant to *N.J.A.C.* 6A:26-3.8(a)(3) and 6A:26-9.1(g), local share budgeted in capital outlay or withdrawn from capital reserve must be transferred to the capital projects fund upon execution of the grant agreement with EDA. Any unexpended transferred capital outlay and/or capital reserve funds remaining after completion of the school facilities project must be reserved and designated in the subsequent year's budget. **Districts may award contracts only after the EDA grant is signed and executed. Revenue for the state share cannot be recorded until the agreement is signed and executed (N.J.A.C. 6A:23-2.11(c), GAAP). The corresponding local share is transferred to the capital projects fund only when the agreement is signed.**

General Rules for EDA Grant Recording:

District staff and auditors should refer to the memorandum with attachments issued by NJDOE October 19, 2001 titled *Procedures for Recording and Accounting for Capital Reserves and EDA Grants* for additional guidance and examples on accounting for EDA grants.

Generally Accepted Accounting Principles require that capital grants or shared revenues restricted for capital acquisitions or construction (other than those associated with enterprise and internal service funds) be accounted for in a capital projects fund (Fund 30). EDA grants are capital grants. The following is a summary of procedures to be followed for EDA Grants.

1. As stated in the regulations, the EDA grants (except for some retroactive grants received for projects that were fully locally funded and completed in 2000-01 as explained in (4) below) plus the local support are to be recorded in the capital projects fund. (N.J.A.C. 6A:26-4.1(a) and (b)).
2. If a non-referendum project receives an EDA grant, per regulations, the grant must be accounted for in Fund 30 and the transfer of local funding sources (capital reserve, capital outlay) to Fund 30 should occur upon execution of grant agreement. (N.J.A.C. 6A:26-4.3(a) and (b)).
3. If the capital project is approved via referendum question, upon voter approval of referendum, which should have included all other local funding sources (e.g. capital reserve, surplus), any local sources identified in the question should be transferred to Fund 30. Upon issuance of the bond, bond proceeds would be recorded, along with the local funding sources, and EDA grant in Fund 30. (N.J.A.C. 6A:26-4.1(d)).
4. For capital projects that received retroactive grants in 2001-02 that were fully funded locally (Fund 12 and/or Fund 20 - early childhood program aid – no referendum question) and completed in 2000-01, the EDA retroactive grant received in 2001-02 is to be recorded in the corresponding fund that originally funded the project.
 - If completed in 2000-01 using capital outlay and/or early childhood program (ECP) funds, the grant should be recorded in Fund 11 as miscellaneous unrestricted state aid with a transfer to Fund 20 (general fund transfer) of the proportionate share of the project paid from ECP monies.
 - EDA retroactive grants reimbursing early childhood program funds must be used for early childhood programs and services in Fund 20.

General Rules for EDA Grant Recording (continued):

5. For capital projects eligible for retroactive grants where the anticipated amount of the grant was funded with bond anticipation notes and the local funding source was capital outlay, the EDA grant is to be recorded in Fund 30 to repay the notes.
6. For retroactive grants received for referenda approved projects, the grant should follow general rules for recording and accounting for EDA grants in Fund 30 as described above in 1-3 and under the regulations. (*N.J.A.C. 6A:26-4.1 et seq.*).

Overexpenditures

A number of situations have been reported to the department where local school districts overexpended a capital projects fund authorization and in some cases used unauthorized methods to fund the overexpenditure. In managing capital projects, the Business Administrator must certify the availability of funds before the board can award contracts and/or a change order on a capital project that increases the cost of the project. (*N.J.A.C. 6A:26-4.9(a)(3)*). In no instance can approval of change orders increase the cost of the project above the bond referendum approved amount. Overexpending a capital project authorization has serious consequences. Under the New Jersey Code of Criminal Justice, it is a crime for a public official or employee to knowingly disburse, order or vote for the disbursement of moneys or incur obligations in excess of appropriations or an amount limited by law (See *N.J.A.C. 6A:26-4.5* and Division of Finance Policy Bulletin 200-11 issued July 1991).

In the event that local school districts overexpended capital projects funds or otherwise violated the procedures described by *N.J.A.C. 6A:23-2.11* and Division of Finance Policy Bulletin 200-13 issued October 1992, auditors must include appropriate comments and recommendations and the amount in the Auditor's Management Report.

Rebatable Arbitrage

The interest paid on debt issued for public purposes by school districts is not generally subject to federal taxation. Accordingly, purchasers of securities are prepared to accept a lower rate of interest on tax-exempt debt than they would on taxable debt of similar quality and duration. "Arbitrage" occurs when a school district profits from this spread in interest rates by investing funds borrowed at the lower tax-exempt rate of interest in higher yielding, taxable securities.

There are certain exceptions that allow arbitrage earnings and they are defined in the IRS Code Sec. 148. A school district may not be required to remit arbitrage rebate payments until several years into the future, but it still must recognize a liability for rebatable arbitrage as soon as it is both probable and measurable that a liability has been incurred. In calculating the amount of the liability, it should be noted that "excess" earnings of one year may be offset totally or in part by lesser earnings in a subsequent year. Therefore, the liability recognized for the year should be only that portion of the estimated future payment that is attributable to earnings of the current period. Typically, arbitrage rebate payments must be made to the federal government every five years and within 60 days of final maturity.

There are two different ways to account for rebatable arbitrage. The first approach is to treat excess earnings as a reduction of interest revenue (if this approach is taken, the liability for rebatable arbitrage is reported in the capital projects fund, rather than in the GLTDAG, even if the liability is not expected to be paid until several years into the future). The second approach is to treat rebatable arbitrage like a claim or judgment. Using this approach, all interest income, regardless of whether it is rebatable, would be reported as revenue of the capital projects fund. The liability for rebatable arbitrage would then be reported in the GLTDAG until due. **GASB 34 Model** – districts should refer to this Audit Program, section II-90.1 and 2 for current guidance on rebatable arbitrage.

Auditor's Note – At the close of construction, both the liability for rebatable arbitrage and related assets typically are removed from the capital projects fund and reported instead in the debt service fund.

Secondary Market Disclosures

Pursuant to the Securities and Exchange Commission Rule 15c2-12, the issuer of bonds (that were issued after July 3, 1995) is to annually provide certain secondary market disclosure information to each nationally recognized municipal securities information repository and with the appropriate State information repository, if any. This information is for the benefit of the bondholders and the beneficial owners of the bonds. All school districts should consult with their bond counsel to determine the information required for filing, filing due date and repository addresses.

Recording Lease Purchase Agreements Involving Issuance of Certificates of Participation (COPS)

Under EFCFA effective July 18, 2000, districts may no longer enter into lease purchase agreements of more than five years duration for the acquisition of a site and building; the acquisition of a site for the construction of new school facilities; and to make additions, alterations renovations and improvements to existing buildings. Lease purchase agreements in excess of five years duration entered into prior to July 18, 2000 may continue in effect through the term of the agreement (N.J.A.C.6A:26-10.8).

Under EFCFA, a district may acquire improvements or additions to school facilities through lease purchase agreements of five years or less provided that the lease purchase agreement provides for the funding in full to the district upon commencement of construction of the school facilities project. A district may utilize a lease purchase agreement of five years or less to fund the local support of a school facilities project provided the capital project is not constructed under the auspices of the authority. The Commissioner will only approve a lease purchase of five years or less which does not include excess costs as defined under N.J.A.C. 6A:26-1.1. A lease purchase agreement of five years or less for improvements or additions to school facilities project that includes excess costs or to an other capital project must be approved by the voters, board of school estimate or capital project review board. Under EFCFA, a district may also acquire equipment through a lease purchase of five years or less but such acquisition does not require Commissioner or voter approval. Lease purchase agreement payments for five years or less are to be recorded as an expenditure of the general fund Districts and auditors should reference N.J.A.C. 6A:26-10.1 et seq. for lease purchase agreements or approval procedures to refinance a lease purchase agreement.

The following section provides information on pre-EFCFA lease purchase agreements (the agreements) involving issuance and defeasance of COPs. It consists of three subsections:

- Subsection 1: Original Lease Purchase Agreements
- Subsection 2: Advance Refunding (Refinance/Defeasance) of the Original Lease Purchase Agreement;
- Subsection 3: Sample disclosure requirements for an original lease purchase agreement and an advance refunding in the "Notes to the Financial Statements" section of the Comprehensive Annual Financial Report (CAFR) and "Administrative Findings-Financial and Performance Reporting - General Comments" section of the Audit Report.

Subsection 1 - Original Lease Purchase Agreements

A. Nature of the Agreements: Prior to the passage of EFCFA, *N.J.S.A.* 18A:20-4.2(f) and *N.J.A.C.* 6:22A-1.2(a) allowed a school district to enter into lease purchase agreements for the acquisition of a site and building; the acquisition of a site for the construction of new school facilities; and to make

additions, alterations renovations and improvements to existing buildings. Agreements in excess of five years entered into prior to July 18, 2000 had to be approved by the Commissioner of Education and the Local Finance Board in the Department of Community Affairs. The school district had to establish that the improvements were needed to provide a thorough and efficient (T&E) education. Under the agreements, investors (COP holders) provide the funding for the project in return for an interest in the future lease payments. The school district, as a lessee, contractually agrees to lease school facilities subject to the provisions of the agreement. The payment schedules included in the agreements break out the interest and principal portions of those payments. A trustee (Agent) is an integral part of the agreement and maintains stewardship over the moneys. The proceeds of the sale of the COPs are held in escrow by the trustee, who also receives the LEA's lease payments; disburses the moneys for the project costs; and makes payments to the certificate holders. The trustee also maintains the various reserve accounts required under the agreement. In accordance with *N.J.A.C.* Title 6, Subtitle D, Section 6:22A-1.2(g)4-ii - "all construction contracts let by public school districts or let by developers or owners of the property used for school purposes shall be competitively bid pursuant to *N.J.S.A.* 18A:20-4.2(f)..."

Normally, the agreements contain a fiscal funding or cancellation clause that permits lessees to terminate the agreement on an annual basis if funds are not appropriated to make the required payments. However, according to the Governmental Accounting Standard Board's (GASB) Codification of Governmental Accounting and Financial Reporting Standards (the Codification) Section L20.122 and 123, the economic substance of most agreements with the fiscal funding or cancellation clauses is that they are essentially long term contracts. If the agreement meets all other capitalization criteria except for the non-cancelable criteria, the likelihood of the lease being canceled must be evaluated. If the possibility of cancellation is remote, the lease should be capitalized.

Prior to the payment of all project related expenditures, draw papers must be approved at an official board meeting by the Board of Education. The Board of Education must maintain separate expenditure and revenue ledgers detailing all project related expenditures and revenues.

B. Accounting and Reporting Requirements: The Codification Section L20.107 states that "subject to the accounting and financial reporting distinctions of governmental funds and expendable trust funds, the criteria of FASB Statement No. 13, Accounting for Leases, as amended and interpreted, should be the guidelines for accounting and financial reporting for lease agreements...". In accordance with Section 1300.104 of the Codification, the activity related to the agreements is recorded in the capital projects fund along with related entries in the general fixed assets account group and the general long-term debt account group. These entries are discussed below.

1. To record budgeted COP proceeds: This entry is similar to that for the issuance of authorized bonds where Estimated Revenues (A/C 30-301) is debited for total proceeds and Appropriations (A/C 30-601) and the Budgeted Fund Balance (A/C 30-303) are credited with the appropriate postings to the fund 30 revenue and expenditure subsidiary ledgers. The budgeted fund balance represents the amount that will be held in reserve and in the event of the LEA's default under the lease, will be applied against the outstanding principal balance. It is not available for use in the construction project. If no default occurs, this amount will be used to reduce the final principal payment. EFCFA amended N.J.S.A.18A:20-4.2 to allow a board of education to acquire improvements or additions to school buildings through lease purchase agreements not in excess of five years. Therefore, this entry will not be applicable in most situations occurring after EFCFA.
2. To record the receipt of COP proceeds: The proceeds from COPs held in the trust by the trustee should be recorded in the capital projects fund by debiting Cash with Fiscal Agents (A/C 30-105) and payments made by the trustee for the issuance costs should be recorded by debiting Expenditures (A/C 30-602) in the capital projects fund. Revenues should be recognized by crediting Revenues (A/C 30-302). The appropriate postings must be made to the fund 30 revenue

and expenditure subsidiary ledgers. A related entry in the general long-term account group is made by debiting Amount Available in the Capital Projects Fund (A/C 90-306) for the amount that will be held in reserve, crediting Lease Obligations (A/C 90-531) for the total principal amount of COPs issued, and debiting Amount to be Provided for Retirement of General Long-Term Debt (A/C 90-305) for the difference between the two. EFCFA amended N.J.S.A.18A:20-4.2 to allow a board of education to acquire improvements or additions to school buildings through lease purchase agreements not in excess of five years. Therefore, this entry will not be applicable in most situations occurring after EFCFA.

3. To record payments to contractors, payments for equipment purchases, and to record interest earned: For the payment made to the contractor and/or payments made for equipment purchases, Expenditures (A/C 30-602) should be debited; to record the interest earned on the assets held in the trust, Revenues (A/C 30-302) is credited; and Cash with Fiscal Agents (A/C 30-105) is credited for the difference between the two. Additionally, for the payment made to the contractor and/or payments made for the equipment purchases, an entry should be made in the general fixed assets account group by debiting Construction in Progress (A/C 80-251) and/or Machinery and Equipment (A/C 80-241) respectively, and by crediting Investment in General Fixed Assets - Capital Projects Fund (A/C 80-713). The appropriate postings must be made to the fund 30 revenue and expenditure subsidiary ledgers.
4. To record periodic payment under the agreement: The periodic payments, for agreements in excess of five years (payments on agreements for less than five years are accounted for in the General Fund), made under the agreement must be split between interest and principal for budgeting and recording purposes as follows:

The interest portion of the lease payment should be budgeted and recorded in the debt service fund using account 40-701-510-833, "Interest Payments-Commissioner Approved Lease Purchase Agreements"

and

The principal portion should be budgeted and recorded in the debt service fund using account 40-701-510-723, "Principal Payments-Commissioner Approved Lease Purchase Agreements."

Additionally, an entry should be made in the general long-term debt account group at the end of the year to reduce lease obligations by the total payments made during the year towards the principal by debiting Lease Obligations (A/C 90-531) and by crediting Amount to be Provided for Retirement of General Long-Term Debt (A/C 90-305).

It should be noted here that the majority of the agreements involve real estate as well as equipment. The department advised the auditors and public school accountants, during GAAP training seminars and in the GAAP Technical Systems Manual, that the total payments made on capital leases for equipment (for example, a monthly payment for a leased copier), should be budgeted and recorded as a rental payment (object code 440) in the appropriate fund. However, the same treatment should not be given to the equipment portion contained in the agreement and the equipment should be recorded as stated in "3" above.

Similar entries, as stated above, should be made over the life of the construction project. The general fixed assets account group should reflect the cumulative construction costs in the Construction in Progress (A/C 80-251) until the project is complete. At that point, the Construction in Progress account should be closed by debiting Buildings and Buildings Improvements (A/C 80-231) and by crediting Construction in Progress (A/C 80-251). The agent agreement should be reviewed for the treatment of any remaining balance of the project.

To summarize the accounting and reporting requirements, the following items should be remembered:

1. The agreements should be accounted for in the capital projects fund.
2. The amounts held in the trust should be reflected in the capital projects fund balance sheet.
3. The proceeds from COPs should be reflected as Revenues - Other Financing Sources - Lease Purchases.
4. Payments made to the contractors should be recorded as Expenditures - Construction Services in the capital projects fund and as Construction in Progress in the general fixed assets account group.
5. When the project is completed, the Construction in Progress account in the general fixed assets account group should be closed to the Building and Building Improvements account.
6. The principal and interest portions of the periodic payment, for agreements in excess of five years, should be reflected as expenditures in the debt service fund character class.
7. The outstanding principal portion of the agreements should be reflected in the general long-term debt account group.
8. If the lease agreements involve the establishment of any reserve funds to be used in the event of default (reserved fund balance), these amounts should also be recorded in the general long-term debt account group as Amounts Available for the Retirement of the Debt.

The entries listed above are explained in the GAAP Technical Systems Manual page nos. 11.14 through 11.16 (for capital projects fund entries), page no. 12.8 (for general fixed assets account group entries), and page no. 13.6 (for general long-term debt account group entries). The GAAP Technical Systems Manual is available from the Department of Education - Publications Department - (609) 984-0905. Auditors and public school accountants are advised to refer to the pages of the manual as stated above; FASB Statement No. 13; and other authoritative literature for further assistance.

C. Disclosure Requirements in the Notes to the Financial Statements:

The disclosure requirements of FASB Statement No. 13 include:

- * General leasing agreements (such as date of the agreement, description of the project, name of the lessor, etc.)
- * The gross amount of assets recorded under capital leases presented by major asset classes.
- * Minimum future lease payments in total and each of the next five fiscal years, presenting a deduction for the amount of imputed interest to reduce the net minimum future lease payments to their present value.
- * Construction in progress (or Buildings and Buildings Improvements account, if the construction is completed) should be included in the "Summary of Changes in General Fixed Assets" disclosure.
- * Lease obligations should be included in the "Changes in General Long Term Liabilities" disclosure.
- * The debt service requirements for capital lease obligations may be combined with the general long-term debt service disclosure or be presented with other lease information.

Subsection 2 - Advance Refunding

- A. Nature of Advance Refunding: An advance refunding of the agreements can be accomplished through:

Issuing new certificates of participation at lower interest rates to refund all or a portion of the existing certificates of participation, thereby lowering the annual rental payments under the agreement, called a refinancing,

or

by completing an early buy out of an agreement by obtaining the approval of the voters or board of school estimate to issue general obligation bonds to acquire the ownership of the property prior to the expiration of the agreement, called a defeasance.

A refinancing agreement in excess of five years must be approved by the Commissioner of Education and Local Finance Board in the Department of Community Affairs. A district board of education proposing to seek voter or board of school estimate approval for a defeasance through the issuance of general obligation bonds, must adopt a resolution requesting the approval of the department and submit to the Commissioner an application for defeasance on a form prescribed by the Commissioner.

An advance refunding results in either, (A) legal defeasance or (B) an in-substance defeasance.

1. Legal Defeasance An advance refunding results in a legal defeasance when the government is released as the primary obligor of the debt and when it is probable that the government will not be required to make future debt service payments. Normally, a legal defeasance is rare in the government environment.
 2. In-Substance Defeasance. An in-substance defeasance occurs when a government is required to deposit cash or other assets that qualify as "essentially risk free as to amount, timing and collection of principal and interest" in an irrevocable trust. To be considered risk free, the assets must be either a direct obligation of the United States Government or an obligation guaranteed by the United States Government obligations. These assets provide cash flows that "approximately coincide, as to timing and amount, with the scheduled interest and principal payments on the debt that is being extinguished." The agreements discussed in this section fall under this category.
- B. Accounting and Reporting Requirements: The refunding bonds (new issue) should be recorded in the general long-term debt account group. In addition, the proceeds of the new issue should be recorded in the capital projects fund as an other source of funds, using the Proceeds of Refunding Bonds account (A/C 30-5700-000). When the payment is made to retire the old issue, the old issue should be removed from the general long-term debt account group and the payment should be recorded in the capital projects fund using Payment to Refunded Bond Escrow (A/C 30-700-530-940).
- C. Disclosure Requirements in the Notes to the Financial Statements: The disclosures per Codification Sec. D20.111 include:
- * A general description of the transaction (such as date of the agreement, description of the project, etc.)

- * The difference between the cash flows required to service the old debt and the cash flows required to service the new debt and complete the refunding.
- * The economic gain or loss (difference between the present value of the old debt service requirements and the present value of the new debt service requirements, discounted at the effective interest rate and adjusted for additional cash paid) and the net present value cost savings or loss as a percentage (economic gain or loss divided by the outstanding bonds under the refunded issue).
- * In all periods following an advance funding for which debt defeased in substance remains outstanding, the amount of that debt, if any, outstanding at period-end.
- * The refunding bonds (new issue) should be included in the long-term debt disclosure which normally include:
 1. A description of issue
 2. Changes in the general long-term debt
 3. Debt service requirements to maturity
 4. Bonds authorized but not issued
- * A description of the outstanding bond issue which normally include:
 1. Purpose of bonds
 2. Original amount of the issue
 3. Type of bond
 4. Amount of installments
 5. Interest rates and
 6. Maturity date range

Subsection 3 - Sample "Notes to the Financial Statements"

The numbers used in the following sample Notes to the Financial Statements are for illustration purposes only and are not related to the Sample Comprehensive Annual Financial Report (CAFR).

Example Note 1 LEASE PURCHASE AGREEMENT (COPs):

On _____, 19XX, pursuant to *N.J.S.A. 18A:20-4.2(f)*, the Board of Education (the Lessee) entered into a school building lease purchase agreement with ABC Lease Corp., Inc., (the Lessor) to finance the construction of additions to and renovations of the existing _____ High School Building. The approval was obtained from the Commissioner of Education of the State of New Jersey and the New Jersey Local Finance Board in the Department of Community Affairs on _____, 20XX. The building is located on land owned by the Board of Education that has been leased to ABC Lease Corp., pursuant to a ground lease agreement dated _____, 20XX. Certificates of Participation (the Certificates) in the par amount of \$5,000,000 were issued and the proceeds budgeted as follows:

Project Construction Fund	\$4,745,000
Reserve Fund	100,000
Cost of Certificate Issuance	<u>155,000</u>
	<u>\$5,000,000</u>

Proceeds from the sales of the Certificates were used to finance the construction of a new library/media center, a counselor center, and the expansion of the physical education facility by constructing an additional two-station gymnasium and equipment. The equipment installed in the building consisted of certain equipment necessary to furnish the library/media center and the counseling center.

Under the lease, the Board is required to pay Basic Rent due on each ____ 1 and ____ 1, commencing ____ 1, 20XX. Basic Rent is composed of an interest component and a principal component. The Certificates carry interest rates in the range of 5.75% to 6.80%; and the Certificates mature on ____ 30, 20XX. Payment of the principal of and interest on the Certificates is insured by XYZ Guaranty Insurance Company. ____ National Bank has been appointed to serve as a trustee in the agreement.

Future Minimum Lease Payments: Future minimum lease payments for the fiscal year under the lease purchase agreement along with the present value of the minimum lease payments as of June 30, 2002 are:

<u>Year Ending June 30</u>	<u>Amount</u>
2003	\$ 341,682
2004	331,870
2005	320,921
2006	308,896
2007	295,745
Thereafter	<u>6,691,962</u>
Total minimum lease payments	\$8,291,076
Less amount representing interest	<u>3,426,076</u>
Present value of lease payments	<u>\$4,865,000</u>

Optional Prepayment: The Certificates maturing on or after ____ 15, 20XX are subject to prepayment on or after ____ 15, 20XX at the option of the Board as a whole at any time or in part on any Interest Payment Date at a redemption price expressed as a percentage of the principal portion of the basic rent represented by the Certificates or portion thereof to be redeemed set opposite such period in the following table plus accrued interest to the date of redemption.

<u>Period (both dates inclusive)</u>	<u>Redemption Price</u>
____ 15, 200X to ____ 14, 200X	102%
____ 15, 200X to ____ 14, 200X	101
____ 15, 200X and thereafter	100

Mandatory Prepayment: The Certificates are subject to mandatory prepayment at a redemption price equal to their principal amount plus accrued interest to the redemption date:

- (A) In whole or from time to time in part (in inverse order of maturities and within a maturity by lot), on any interest payment date, from the net proceeds of insurance or condemnation proceedings, together with any available revenues permitted to be applied to the purpose, if the Board determines not to repair, restore or reconstruct the Project or the affected portion thereof or,
- (B) In whole, at any time, with the consent of the Insurer, from moneys received by the Agent on the exercise of its rights under the Agent Agreement with respect to an event of default or an event of nonappropriation.

Example Note 2 ADVANCE REFUNDING:

- (A) REFINANCE: The Board of Education (the Lessee) adopted a resolution on _____, 15, 20XX, for the purpose of issuing Refunding Certificates of Participation (the Refunding Certificates) in order to advance refund all of the outstanding Certificates of Participation dated _____ 15, 19XX, (the Prior Certificates) which were issued to finance the construction of additions to and renovations of the existing _____ High School Building. The building is located on land owned by the Board of Education that has been leased to ABC Lease Corp., Inc. (the Lessor) pursuant to a ground lease agreement dated _____ 15, 19XX. Proceeds from the sale of the Prior Certificates were used to finance the construction of a new library/media center, a counselor center, and the expansion of the physical education facility by constructing an additional two-station gymnasium and equipment. The equipment installed in the building consisted of certain equipment necessary to furnish the library/media center and the counseling center.

The approval was obtained from the Commissioner of Education of the State of New Jersey on _____ 15, 20XX and the New Jersey Local Finance Board in the Department of Community Affairs on _____ 15, 20XX.

On _____, 20XX, the Board of Education issued \$4,500,000 Refunding Certificates and the proceeds of the Refunding Certificates were deposited into an escrow fund and, together with other available funds, were used to pay all principal and interest on the Prior Certificates on each principal and interest payment date up to and including _____, 20XX, to redeem the balance of the outstanding Prior Certificates and to fund a reserve fund and to pay certain issuance costs associated with the issuance of the Refunding Certificates.

Under the Refunding Certificates, the Board is required to pay Basic Rent due on each _____ 1 and _____ 1, commencing _____ 1, 20XX. Basic Rent is composed of an interest component and a principal component. The Refunding Certificates carry interest rates in the range of 5.75% to 6.80%; and mature on _____ 30, 20XX. Payment of the principal of and interest on the Refunding Certificates is insured by XYZ Guaranty Insurance Company. _____ National Bank has been appointed to serve as a trustee in the agreement.

As a result of this transaction, the Prior Certificates are considered to be defeased and accordingly, the related liability has been removed from the general long-term debt account group. This advance refunding was undertaken to reduce the total payments over the next _____ years by \$ _____ and to obtain an economic gain (difference between the present value of the lease purchase payments for the Prior Certificates and the Refunding Certificates, discounted at the effective interest rate) of \$ _____ which resulted in a net present value cost savings of _____% (economic gain divided by the outstanding bonds under the refunded issue).

Future Minimum Lease Payments: Same as shown in Example Note 1.

Optional and Mandatory Prepayment: Same as shown in Example Note 1.

- B. DEFEASANCE: The voters of the school district voted in the affirmative of a special election held on _____, 20XX to authorize the issuance of bonds (Refunding Bonds) to provide funds to defease, in whole, the outstanding 19XX Certificates of Participation (the Prior Certificates). The Prior Certificates dated _____, 19XX, were issued to finance the construction of additions to and renovations of the existing _____ High School Building. The building is located on land owned by the Board of Education that has been leased to ABC Lease Corp., Inc. pursuant to a ground lease agreement dated January 15, 19XX. Proceeds from the sales of the Prior Certificates were used to finance the construction of a new library/media center, a counseling center, and the expansion of the physical education facility by constructing an additional two-

station gymnasium and equipment. The equipment installed in the building consisted of certain equipment necessary to furnish the library/media center and the counseling center. Approval for the defeasance was obtained from the Commissioner of Education of the State of New Jersey on _____, 20XX.

The sale of the Refunding Bonds and the receipt of the proceeds was consummated on _____, 20XX. Direct obligations of the United States Government were purchased and irrevocably deposited into an escrow fund. The Refunding Bonds are dated _____, 19XX and will mature on _____, 20XX. The Refunding Bonds carry interest rates in the range of ____% to ____%. As a result of this transaction, the Prior Certificates are considered to be defeased and accordingly, the related liability has been removed from the general long-term debt account group. This advance refunding was undertaken to reduce total payments over the next ____ years by \$____ and to obtain an economic gain (difference between the present value of the lease purchase payments for the Prior Certificates and the debt service payments for the Refunding Bonds, discounted at the effective interest rate) of \$____ which resulted in a net present value cost savings of _____% (economic gain divided by the outstanding bonds under the refunded issue).

Note: Other related disclosures regarding the Refunding Bonds (new issue) such as, debt service requirements to maturity, changes in the general long-term debt, etc. may be included in the general long-term debt disclosure note.

Optional and Mandatory Prepayment: Same as shown in Example Note 1.

NOTE: The following illustrative comments are for guidance and will be included in The Auditors' Management Report on Administrative Findings - Financial, Compliance and Performance.

Lease Purchase Agreements Involving Issuance of Certificates of Participation: The Lease Purchase Agreement; Ground Lease Agreement; and the Agent Agreement were reviewed. As stated in Note X to the financial statements, _____ National Bank was appointed as an Agent (trustee) in the agreement. In accordance with the Agent Agreement, a Project Account was established from which the funds were disbursed to the contractor towards the Project costs. The Agent Agreement requires that the Lessee (the Board of Education) should advise the Agent in writing of the aggregate amount of funds needed for disbursement to pay any project costs by submission of Draw Papers and that the Agent should make the disbursement of the funds requested from the Project Account. Additionally, *N.J.A.C.* Title 6, Subtitle D (Adopted October 6, 1993), Section 6:22A-1.2(g)4ii states that "All construction contracts let by public school districts or let by developers or owners of property used for school purposes shall be competitively bid pursuant to *N.J.S.A.* 18A:20-4.2(f)..."

We reviewed the draw papers, along with the supporting documentation, for proper authorization, completeness, and accuracy. All construction contracts were competitively bid and the review of the Draw Papers disclosed no areas of statutory noncompliance.